

DEPARTMENT OF CORPORATIONS

SACRAMENTO, CALIFORNIA



IN REPLY REFER TO:

FILE NO: OP 6763COMMISSIONER'S OPINION 99/1C

THIS LETTER IS NOT AN INTERPRETIVE OPINION
FOR THE REASONS STATED BELOW

Mr. Michael G. Fraunces
Luce, Forward, Hamilton & Scripps LLP
600 West Broadway, Suite 2600
San Diego, California 92101

Re: Stephen W. Boney LLC

Dear Mr. Fraunces:

The Commissioner of Corporations ("Commissioner") has considered your request for an interpretive opinion contained in your letter dated August 12, 1999. Your letter requests an interpretive opinion with regard to whether a limited liability company may rely upon the exemption from qualification found in Corporations Code Section 25102(n) of the Corporate Securities Law of 1968 ("CSL") to offer and sell limited liability company ("LLC") membership interests to "qualified purchasers" as defined in subparagraph (E) of paragraph (2) of Section 25102(n). For the reasons stated below, we conclude that the exemption provided under Section 25102(n) cannot be relied upon by a LLC if the LLC offers or sells membership interests to "qualified purchasers" as defined in subparagraph (E) of paragraph (2) of Section 25102(n) of the CSL.

You represent that Stephen W. Boney, an individual, intends to form a LLC ("Boney's LLC") under California law. Once formed, Boney's LLC will initiate an offering pursuant to the exemption from qualification provided in Section 25102(n) of the CSL with the goal of raising approximately \$5,000,000. You represent that Boney's LLC will use the proceeds of the offering to develop and operate independent, natural foods grocery stores in southern California.

You further represent that Boney's LLC will have one class of voting members only and that the membership interests will have voting rights equivalent to or better than holders of voting common stock of a California corporation. Additionally, the Manager or Managers of Boney's

LLC will have rights and duties similar to those of a Board of Directors of a California Corporation. Finally, Boney's LLC desires to sell membership interests to "qualified purchasers" as defined in subparagraph (E) of paragraph (2) of Section 25102(n).

Section 25110 of the CSL provides that it is unlawful for any person to offer or sell in this state any security in an issuer transaction unless such sale has been qualified pursuant to Section 25111, 25112 or 25113 of the CSL or unless such security or transaction is exempted or not otherwise subject to qualification.

Section 25102(n) provides an exemption for certain securities transactions from the qualification requirements of Section 25110. Specifically, the exemption specifies several detailed criteria for the limited offering of securities to sophisticated investors, including, among other things, the requirements that: (1) the issuer is a California corporation, or a foreign corporation that meets specified criteria, or any other business entity organized under the laws of this state (Section 25102(n)(1)); (2) the sales of securities are made only to qualified purchasers the issuer reasonably believes to be qualified (Section 25102(n)(2)); (3) each person receives a written offering disclosure statement before the securities are sold to the purchaser (Section 25102(n)(4)); (4) a general announcement with specified information is published by "written document only" (Section 25102(n)(5)); and (5) no telephone solicitations are allowed prior to the issuer determining that the potential investor is qualified (Section 25102(n)(6)).

As indicated in paragraph (1) of Section 25102(n), any business entity, including an LLC, that is organized under the laws of this state may issue securities pursuant to this exemption provided that the other criteria of Section 25102(n) are met. Paragraph (2) of Section 25102(n) specifies the categories of qualified purchasers to whom issuers relying on this exemption may offer or sell securities. Subparagraph (E) of paragraph (2) of Section 25102(n) describes one particular category of qualified purchasers. Specifically, subparagraph (E) provides that qualified purchasers for purposes of Section 25102(n) may include individuals (and their spouses) that meet specified minimum net worth and income requirements as well as business or financial experience so that the individuals can be reasonably assumed to have the capacity to protect his or her interests in connection with the transaction. However, individuals (and their spouses) that meet the specified net worth requirements of subparagraph (E) will only be considered qualified purchasers for the purposes of Section 25102(n) if the transaction involves the offer and sale of one class of voting common stock of an issuer or of preferred stock of an issuer that entitles the holder thereof to at least the same voting rights as the issuer's one class of voting stock, provided that the issuer has only one-class of voting common stock, outstanding upon consummation of the offer and sale.

By definition, the term "common stock" refers to securities which represent an ownership interest in a corporation and which have no preference over any other shares with respect to distribution of assets on liquidation or with respect to payment of dividends. (See Corporations Code Section 159 and Black's Law Dictionary pages 1415 - 1419, Sixth Edition (1990).

Likewise, “preferred stock” by definition is a class of stock of a corporation which is accorded preference or priority in respect to dividends. See Corporations Code Section 184.)¹ Under the rules of statutory construction, if the words of the statute, given their ordinary and popular meaning are reasonably free from uncertainty, courts will look no further to ascertain legislative intent. (See 58 Cal Jur 3d, Statutes, Section 84.) Additionally, technical words are interpreted in accordance with the usual understanding given them by persons in the profession or business to which they relate, unless clearly used in a different sense. (See 58 Cal Jur 3d, Statutes, Section 125.) Thus, as “stock” is ordinarily understood to mean an interest in a corporation, the language of the subparagraph (E) of paragraph (2) of Section 25102(n) of the Corporations Code is clear on its face and applies solely to corporations. This interpretation is bolstered by the fact that Section 25019 of the Corporations Code, which defines the term “security” for purposes of the CSL, refers to stock and membership interests in LLCs as separate types of securities. Additionally, the unique relationship of stock to corporations is recognized in Marsh’s California Corporation Law: “[t]he issuance of shares or stock to represent the equity ownership of the business is, of course, peculiar to the corporate form of organization...” Marsh’s California Corporation Law, 307, Third Edition, (1999). Moreover, the first sentence of subparagraph (E) of paragraph (2) of Section 25102(n) is indicative of the Legislature’s intent to distinguish this particular category of qualified purchaser from the other categories of qualified purchasers listed in paragraph (2) by specifying that the subparagraph applies only “with respect to the offer and sale of one class of voting common stock or of preferred stock...” whereas the first sentence of paragraph (2) refers to “sales of securities” in general.

Accordingly, based upon the facts presented to us, and the reasons set forth above, it is our opinion that the Boney’s LLC may not rely on the exemption provided in Section 25102(n) if it offers or sells membership interests to “qualified purchasers” as defined in subparagraph (E) of paragraph (2) of Section 25102(n), as membership interests in LLC’s are not “stock.”

However, we note that, although subparagraph (E) of paragraph (2) of Section 25102(n) cannot be relied upon by the Boney’s LLC, Section 25102(n) provides other categories of “qualified purchasers” that may be available to the Boney’s LLC, including subparagraph (A) which defines “qualified purchasers” as persons designated in Section 260.102.13 of Title 10 of the California Code of Regulations. Section 260.102.13 designates various categories of individuals, including, among other categories, individuals that come within the categories of an “accredited investor” under Rule 501(a) of Regulation D adopted under the federal Securities Act of 1933.

¹ Sections 159 and 184 of the Corporations Code define the terms “common shares” and “preferred shares;” however, the terms “stock” and “shares” are used interchangeably under California law. “In the 1977 [General Corporation] Law as in the [General Corporation Law of 1931], such units of ownership interest are called “shares,” although the term “stock” is perhaps more commonly used in other corporation laws to refer to the same concept. There is no distinction between these two words; they are merely used to refer interchangeably to the same idea.” See Marsh’s California Corporation Law 307, Third Edition (1999)

Inasmuch as interpretive opinions are issued for the principle purpose of providing a procedure by which members of the public can protect themselves against liability for acts done or omitted in good faith reliance upon the administrative determination made in the opinion, and since there can be no such reliance where the Commissioner asserts jurisdiction with respect to a particular situation or determines that a legal requirement is applicable, advice to that effect, as contained in this letter, does not constitute an interpretive opinion.

Date: November 22, 1999
Sacramento, California

A handwritten signature in dark ink, appearing to read 'Wm. Kenefick', written over a horizontal line.

WILLIAM KENEFICK
Acting Commissioner of Corporations
(916) 322-3553

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LUCE, FORWARD, HAMILTON & SCRIPPS LLP

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MICHAEL G. FRAUNCES

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August 12, 1999

BY: FEDERAL EXPRESS

Mr. Gary S. Mendoza
Commissioner of Corporations
c/o Office of Policy
980 9th St., Suite 500
Sacramento, CA 95814-2725

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DEPT OF CORPORATIONS
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Re: Stephen W. Boney

Dear Mr. Mendoza:

This firm represents Stephen W. Boney, an individual, who intends to form a limited liability company under California law (the "Boney's LLC"). Once formed, the Boney's LLC will initiate a private placement offering pursuant to the exemption from qualification provided in §25102(n) of the California Corporate Securities Law (the "Law") with the goal of raising approximately Five Million Dollars (\$5,000,000). The Boney's LLC will use the proceeds of the offering to develop and operate independent, natural foods grocery stores in Southern California. The Boney's LLC will have one class of voting members only. The membership interests will have voting rights equivalent to or better than holders of voting common stock of a California corporation. The Manager or Managers of Boney's LLC will have rights and duties similar to those of a Board of Directors of a California corporation. The Boney's LLC desires to sell membership interests to "qualified purchasers" as that term is defined in §25102(n)(2)(E) of the Law. This letter requests an interpretive opinion with regard to whether the Boney's LLC may rely upon the exemption from qualification found in §25102(n) of the Law to offer and sell securities to the subset of "qualified purchasers" defined in §25102(n)(2)(E).

Under §25110 of the Law, all offers or sales of securities by issuers in California must be either qualified with the Commissioner or exempt from such qualification. §25102(n) of the Law provides an exemption for the offer and sale of securities in a limited public offering to certain "qualified purchasers," provided that the issuer meets certain criteria set forth in §25102(n). §25102(n)(2)(E) provides in pertinent part that such "qualified purchasers" include:

With respect to the offer and sale of one class of voting common stock of an issuer or of preferred stock of an issuer entitling the holder thereof to at least the same voting rights as the issuer's one class of voting common stock, provided that the issuer has only one-class voting common stock outstanding upon consummation of the offer and

Mr. Gary S. Mendoza

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sale, a natural person who, either individually or jointly with the person's spouse, (i) has a minimum net worth of two hundred fifty thousand dollars (\$250,000) and had, during the immediately preceding tax year, gross income in excess of one hundred thousand dollars (\$100,000) and reasonably expects gross income in excess of one hundred thousand dollars (\$100,000) during the current tax year or (ii) has a minimum net worth of five hundred thousand dollars (\$500,000) . . .

We believe the Legislature intended to allow a limited liability company to rely upon the §25102(n) exemption to offer and sell securities to the "qualified purchasers" listed in §25102(n)(2)(E). §25102(n)(1)(B) states that the §25102(n) exemption may be utilized by not only a corporation but also "any other form of business entity, including without limitation a partnership or trust organized under the laws of this state." The reference to "any other form of business entity" clearly demonstrates the Legislature's intention to make the §25102(n) exemption available for use by a limited liability company.

Moreover, the Legislature's overriding goal in enacting the §25102(n) exemption was to facilitate the ability of small companies to raise capital and finance their growth. *See* 1994 Stats, Ch. 828, §3. One of the principal means by which the Legislature achieved this goal was to set the "qualified purchaser" standard in §25102(n)(2)(E) at a level significantly lower than the standard for "accredited investor" found in Rule 501 of Regulation D under the Securities Act of 1933 and "Excluded Purchaser" found in §260.102.13 of Chapter 3, Title 10 of the California Code of Regulations, thus greatly expanding the pool of investors available to small companies engaged in limited offerings of securities. Therefore, to prevent limited liability companies from offering securities to the "qualified purchasers" defined in §25102(n)(2)(E) would significantly limit such companies' access to investors, thereby defeating the fundamental purpose of the statute.

The Legislature's specific references to "voting common stock" and "preferred stock" with voting rights at least the same as that of the issuer's voting common stock in §25102(n)(2)(E) arguably were intended to be generic in nature to describe voting equity securities in which the holders have similar and equal voting privileges. There exists no legislative history, committee report or other legal authority which supports a contrary view. The voting structure for members of the proposed Boney's LLC will provide equal voting rights among a single class of voting members. These members will have voting rights the same or better than those of common shareholders of a California corporation. With this structure, we believe the proposed voting membership interests of Boney's LLC satisfies the intent of the Legislature when the Legislature specifically designated "voting common stock" and "preferred stock," in §25102 (n)(2)(E).

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In light of the foregoing, we respectfully request that the Commissioner issue an interpretive opinion confirming that the Boney's LLC may rely upon the §25102(n) exemption to offer and sell the type of voting membership interests described above to the subset of "qualified purchasers" defined in §25102(n)(2)(E), and provided further that all of the other conditions of §25102(n) are met.

Sincerely yours,



Michael G. Fraunces
for
Luce, Forward, Hamilton & Scripps LLP

cc: Mr. Stephen W. Boney